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SUBJECT: EMINENT PERSONS' GROUP SUGGESTS A NEW FRAMEWORK  
FOR U.S.-JAPAN ECONOMIC DIALOGUE

11. (SBU) Summary: An eminent persons' study group organized by the Ministry of Foreign Affairs (MOFA) will report to Foreign Minister Nakasone January 23 on its work regarding a new economic dialogue between the U.S. and Japan. MOFA officials called in econoffs to say the group recommends the dialogue focus on five pillars: economic growth, global issues, economic and trade relations with emerging economies, U.S.-Japan engagement in the Asia-Pacific region, and economic reform. Chaired by Deputy Foreign Minister Yoichi Otabe, the study group argues the U.S. and Japan should conduct their future economic dialogue through two parallel tracks, one focused on global issues such as climate change and energy, the other on economic growth as well as trade and investment liberalization. MOFA would like to see a new dialogue launched as early as July 2009, but has not begun formal coordination with other ministries on a unified position. Second North America Division Director told econoffs MOFA will continue to consult with Washington on the process. The English translation MOFA provided of the report is contained in paragraph 6. End summary.

12. (SBU) A study group chaired by Deputy Foreign Minister Otabe identifies five pillars that should constitute the framework for a new U.S.-Japan economic dialogue, according to Noriyuki Shikata, Director, MOFA Second North America Division. The report also envisions engagement proceeding on two parallel tracks: global issues (climate change, energy, food security, emerging economies, the role of the IMF) and a "strategic economic dialogue" that would focus on growth as well as trade and investment liberalization. Shikata called in econoffs to preview the study group's draft report, which MOFA is to provide in final to the media following the group's briefing to Minister Nakasone January 23. Shikata said he had discussed some of these proposals during his visit to Washington in January. MOFA plans to post Japanese and English language versions of the report on its website: <http://www.mofa.go.jp/region/n-america/us/index.html>.

The Five Pillars

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¶3. (SBU) The report's five pillars cover areas it identifies as key for economic cooperation in the U.S.-Japan bilateral relationship:

¶I. Economic Growth.

II. Global issues.

III. Coordinated approaches to economic and trade relations with emerging economies.

IV. U.S.-Japan engagement in the Asia-Pacific region.

¶V. Growth through economic reform in both the U.S. and Japan (reform of Japan's agriculture sector, tax system, and education are among the areas mentioned in the report.)

¶4. (SBU) Shikata said the study group's recommendations reflect a consensus that while there were a number of successes under the current regulatory reform, investment, and trade-related initiatives that comprise the U.S.-Japan Economic Partnership for Growth, recent progress has been limited. The report cites Japan's agriculture policy as a continued impediment to the GOJ's ability to play a more active role in the WTO Doha Development Agenda. Similarly, without changes in government positions on agriculture, it cautions Japan will lag further behind countries such as China, Korea,

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and Australia that are more aggressive in concluding free trade agreements.

"No Drastic Changes"  
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¶5. (SBU) Shikata said the report proposes "no drastic changes" to current U.S.-Japan engagement on economic and trade issues, although he noted a possible standalone dialogue on global issues such as climate change, the environment, and energy would represent a break from the current, unified dialogue format. Shikata said the GOJ hopes that PM Aso could meet with the President before the G-20 Leaders Summit in London April 2, possibly as early as February, and that the new modalities for a dialogue could be announced in July at the Rome G-8 Leaders' Summit. He said MOFA has not yet begun coordinating with other ministries on a GOJ-wide position for a future U.S.-Japan dialogue and that MOFA wants to consult with the new Administration throughout this process.

¶6. (SBU) Text of the Study Group's Report (English translation provided by MOFA):

Begin text:

"Proposal for the construction of the future Japan-U.S. economic relationship under the new U.S. administration"

provisional translation (issued on 23rd January, 2009)

Report of: "The Advisory Panel for the coming global economy and the Japan-U.S. economic relationship"

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## Introduction

In 2008, global financial/economical market faced the so-called "once-in-a-century" crisis. This crisis stemmed from the world's largest economy - the U.S. Financial uncertainty in the U.S. which stemmed from the sub-prime mortgage loan problem led to a global financial crisis upon the bankruptcy of the Lehman Brothers, and deeply affected other countries' real economies, not to mention within the U.S. The crisis revealed problems in financial/economic system of each country. It also revealed that we need wisdom and drastic approach in order to overcome this crisis and settle the economy back on a new growth track.

We cannot discuss global finance/economy without

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considering the roles and responsibilities not only of the developed countries, but also of emerging economies and the resource-rich countries as seen in the "Summit on Financial Markets and the World Economy" held last November, and in the stagnant WTO Doha round talks. Moreover, we cannot discuss tackling global issues such as poverty, climate change, energy and food without cooperation from these countries. However, regarding such transformation of the international society, Japan and the U.S., the two largest economies, are strongly expected to exercise their leadership, and to fulfill their appropriate roles and responsibilities.

Under these circumstances, Mr. Barack Obama was inaugurated as the 44th U.S. President on January 20th, 2009 and the Obama administration has started. For both Japan and the U.S., the first priority issue for the time being, is to work on swiftly implementing effective measures to stimulate the domestic economy. However, overcoming the current severe financial/economic situation and creating a new economic growth model therefrom and then leading the global economy, is not only indispensable for the growth of Japan and the U.S., but also the most important task for which the two countries need to cooperate and pursue under the current situation because the two countries are the world's largest economies in alliance. To that end, what exactly should Japan and the U.S. achieve under coordination? Moreover, what kind of a role should Japan and the U.S. cooperatively play in the process of building international economic order after overcoming the financial crisis?

Being aware of the facts mentioned above, our panel has been gathered and discussing since last September, responding to invitations from Director-General of Economic Affairs Bureau of the Ministry of Foreign Affairs. Hereby, we present our report based on these discussions to Minister of Foreign Affairs of Japan, as a proposal for the Japanese economic diplomacy toward the U.S. The proposal connotes messages given toward the U.S. government, the Japanese and the U.S. citizens, business communities, mass media and the NGOs. The

proposal also addresses some issues that Japan has to tackle for its own growth. The effect of the proposal will be enlarged through cooperation with the U.S., the only ally of Japan, and hence the proposal will benefit the U.S., Asia-Pacific region and the international community as a whole. We hope the proposal will inspire the Japanese economic diplomacy toward the U.S.

Opinions expressed in the panel by the panel members belong to each individual panel member and hence do not represent the views of the organizations to which they belong.

(Drafted by): The Advisory Panel for the coming global economy and the Japan-U.S. economic relationship.

#### 1. Situation surrounding the economic relationship between Japan and the U.S.

The economic relationship between Japan and the U.S. has changed from the relationship characterized by "friction" to that of "cooperation". Japan's share in the U.S. trade deficit, which peaked at around 70% in 1991, has since steadily decreased to around 10% in 2007. Through such factors, economic friction issues that become political problems have decreased in the current economic relationship between Japan and the U.S., and it can be said that the relationship has become more smooth and friendly. Those who take up this situation negatively say that the age of "Japan bashing" has shifted to the age of "Japan passing", and further on to the age of

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"Japan nothing."

In reality however, the importance for Japan and the U.S. to further strengthen the bilateral economic relationship and to promote Japan-U.S. cooperation in tackling the various challenges in the Asia-Pacific region and on the global level, has never been greater. In making this proposition on Japan's new economic diplomacy toward the U.S., we would like to briefly reflect upon the current situation surrounding the economies of Japan and the U.S.

The U.S. economy is undergoing a recession due to the current severe financial/global economic situation. President Obama has called for job creation through technological innovation/expansion of public works in the energy/environment sector, and the U.S. Government/Congress cannot avoid concentrating on the domestic economic recovery measures such as the reconstruction of the automobile industry and employment measures. In the mid to long term, issues such as the review of the financial supervision system, reduction of the fiscal deficit, that will grow due to the domestic economic recovery measures, and the suppression of excessive consumption, must be tackled and the global imbalance problem must be dealt with. It may be said that the economic growth model of the U.S. is coming to a turning point.

The Japanese economy's recession is also expected to continue for the time being. There are concerns that developments such as the rapid reduction in manufacturing industry output could lead to large scale job losses, and there are risks that the economy may stagnate further from the effects of the global recession and the massive fluctuations in the stock and foreign exchange markets. Institutional harmonization has progressed significantly and consumer benefits have grown through the bi-directional Japan-U.S. Regulatory Reform and Competition Policy Initiative etc. However, foreign direct investment in Japan remains small. Japan's economic partnership agreement (EPA) policy, which Japan has been promoting mainly in Asia, is becoming limited in new initiatives. Despite this, structural reform in the

agricultural sector has not seen such progress that would otherwise make further liberalization possible, and options available for Japan's WTO/EPA policy remain limited. While Australia and New Zealand as well as South Korea and China actively advance their FTAs, Japan would be left behind if nothing is done. Japan is also on the defensive in the WTO Doha round talks in the agricultural sector, and has not been able to take the leadership to advance the negotiations.

The global economy is in a state of difficulties too. Several small/medium-sized countries have asked for emergency loans from the IMF, and negative effects are appearing in the real economy. Although countries that are highly dependent upon foreign demand need to take on a more autonomous domestic demand-driven economic growth model, the promotion of free trade/denial of protectionism must be upheld at the same time. Furthermore, the world needs to address new global challenges, such as "climate change/energy security" that is vital for future economic growth, "development issues" including overcoming poverty/the income gap and spreading medical/health services including infectious disease prevention, and "food security", through collective actions. Here, we need to focus on the fact that the constitution of "players" in the global economy has changed though the rise of the emerging economies such as China and India and the resource-rich countries in the Middle East and Russia. The roles and responsibilities of these emerging economies within the global economy are becoming ever more important. Additionally, with this

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development, it is becoming necessary to review the state of international financial and economic institutions, including the IMF.

## 12. Proposition 1: 5 pillars of the "New Japan-U.S. Economic Relationship"

The points raised in 1 above are just some examples; there are other new challenges piled up before Japan and the U.S., which are allies as well as the two largest economies in the world. By cooperating with the U.S. in tackling those challenges, Japan can overcome the current global financial crisis, re-boost its economy and strengthen its national power. Cooperation between Japan and the U.S. will not only contribute to the national interest of Japan, but will also benefit the U.S. and the global economy. Japan and the U.S. should cooperate and lead the world to construct the post-crisis global economic order. Therefore, we propose the following 5 pillars in order to construct a new Japan-U.S. economic framework.

### (1) Creating a new post-financial crisis economic growth model

Overcoming the current global financial/economic crisis will not mean getting to settle the economy back to how it was before the crisis. The economy in the post-crisis era should be harnessing new forms of industry. The U.S. economy is now coming to a turning point, and as a matter of fact, the Japanese economy is too. Once the current crisis is overcome, the nation that can not only prevent repeating the same mistake in the future, but also establish a more advanced economic growth model will lead the next era. In this regard, it is worthy to note that President Obama has been emphasizing action in the energy/environment sectors within the context of his economic recovery measures. Both Japan and the U.S. are allies with much wisdom and technology in broad/various sectors including energy/environment. Japan and the U.S. must overcome the current crisis, and lead the coming global economy by creating a new economic growth model, for example, which will organically link sectors of

"energy", "the environment" and "economy."

## (2) Cooperation in tackling global challenges

It is indispensable to prepare an economic environment/order in which the entire world may achieve sustainable growth. Each country must work together as one in order to face the challenge of various global issues such as climate change/energy, development, including poverty/healthcare policies, and food security. Furthermore, regarding economic rules, under the current economical/financial crisis, each nation should work to maintain and strengthen its economic system based on universal principles, such as building an adequate financial supervision system, promoting free trade/denial of protectionism, and protecting intellectual property rights. In fields such as climate change/energy sectors where Japan has advantages in the face of technology and experience, the effects of cooperating with the U.S. increases all the more. Concerning the promotion of free trade/denial of protectionism, Japan and the U.S. should collaborate and demonstrate leadership toward an early conclusion of the stagnated WTO Doha Round talks.

## (3) Collaboration in the approach toward emerging economies

How shall we get the emerging economies, including China and India, involved responsibly in the global economic system? This is an issue that cannot be avoided. Emerging economies are the negotiating partners in the

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field of global economy, as well as the rosy future market for Japan and the U.S. Therefore, Japan and the U.S. have challenges in common to face, such as protection of intellectual property rights, building business environment for investment, rules in the financial system, competition policy and foreign aid policy. Japan and the U.S. already have their respective experiences in continuing dialogue with emerging economies in the context of encouraging them to take up a more constructive role in the global economy. Japan and the U.S. should consider adjusting policies more closely by sharing their experiences and their future directions. Moreover, close cooperation between Japan and the U.S. is also essential in renovating international institutions for these countries to play a more important and responsible role.

## (4) Sufficient Commitment of Japan and the U.S. in the Asia- Pacific Region

Asia-Pacific Region remains the "Growth Center of the Global Economy." The economic growth in this region is vital for the economic growth of the world as well as Japan and the U.S. Looking at this region as a "face", Japan and the U.S., allies and the world's two largest economies, must be fully involved and construct an economic architecture based on high-standard economic rule, including trade, investment and service. One of the means for this is to build broad economic partnerships. Presently, concepts such as ASEAN+3 (Japan, China and Korea), ASEAN+6 (Japan, China, Korea, Australia, New Zealand and India) and FTAAP (Free Trade Area of the Asia-Pacific) are in the process of being studied and discussed. TPP (Trans Pacific Partnership) is in the stage of negotiation with the U.S. among its participants. The U.S. intends to increase participating countries in the TPP for the purpose of shifting the TPP to the realization of the FTAAP in the future. Therefore, Japan must fulfill a leading role in the approach to broaden economic partnership among the Asia-Pacific Region.

In this regard, process in the negotiation of APEC maybe

useful. The chair of the APEC will be Singapore in 2009, Japan in 2010, and the U.S. in 2011. The year 2010, the host year for Japan, will be the milestone for the developed countries to achieve the Bogor Declaration, and since Japan and the U.S. will chair sequentially, it will be a perfect opportunity for the two to work together and to discuss on the economic architecture in the Asia-Pacific region. Both Japan and the U.S. must contribute to the reevaluation of APEC by strategically planning the next three year-process in-depth.

Among Japan-U.S. relations, negotiation on Japan-U.S. EPA, which has been suggested from both of the economic communities, must move into preparation promptly. Realization of Japan-U.S. EPA will not only broaden/deepen the economic relationship between two countries, but also will enforce broader relationship between the two, and furthermore, will even benefit to stabilize and develop the growth in the Asia-Pacific region. For this purpose, it is necessary to clean away the impediments for commencing negotiations, preferably soon.

#### (5) Continuation of Japan-U.S. "Economic Growth through Reform"

Japan-U.S. economy will not revitalize without "Economic Growth through Reform." The U.S. economy is at a turning point, and issues such as overhauling the financial supervision system in the U.S. are matters of urgent need. At the same time, Japan also has many fields where

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reforms are still necessary. For example, the high corporate tax rate and the lack of human resources required by foreign firms entering the Japanese market are common issues raised as reasons why foreign direct investment in Japan does not readily increase. Tax and education reform is necessary in order to solve this problem. As for structural reforms on agriculture, although structural reform to enhance the robustness increases the efficiency of Japanese agriculture, through measures such as reduction of cost by maximizing scales, are necessary for further liberalization of agricultural imports, however, such preparation is not ready. Therefore, options in trade policy are limited, and Japan is forced on the defensive at the WTO Doha Round talks and the Japan-Australia EPA negotiations are not going smoothly. Under such circumstances, Japan's participation in a Japan-U.S. EPA or an even larger economic partnership is unrealistic, but is that acceptable? Without promoting free trade, there will be no future for Japan. Structural reforms in agriculture are also necessary to ensure food security of Japan. At the same time, free trade policy supports food security for the country by ensuring stable import of food. Therefore, agricultural structural reform is indispensable to advance trade policy. There is no way forward for Japan's trade policy unless the current situation, where decisions are made only after when Japan is isolated. There is no doubt that consumers of the two countries have benefited from the interactive Japan-U.S. dialogue on regulatory reform. Such reform should be continued through political leadership and the deepening of public understanding.

Furthermore, for example, it is worth considering sharing the lessons of successes and failures in the relationship between Japan-U.S., by including other Asian nations in a similar framework as that between Japan and the U.S. for a dialogue on regulatory reforms, towards liberalizing the world economy.

#### 13. Proposition 2: The new framework for Japan-U.S. economic dialogue



Japan and the U.S. established economic dialogues such as "MOSS Consultation" (market-oriented, sector selective: Reagan administration), "Structural Impediments Initiative" (SII: George H.W. Bush administration) and "Japan-U.S. Economic Partnership for Growth" (George W. Bush administration), and have led to reduction of "friction" and brought economic growth to both countries. In particular, the most recent multilayered framework of dialogue such as the "Subcabinet Economic Dialogue", "Regulatory Reform and Competition Policy Initiative", "Trade Forum", "Financial Dialogue" and the "Investment Initiative" under the "Japan-U.S. Economic Partnership for Growth" has contributed to deepen Japan-U.S. economic relationship from "friction" to "cooperation." Being aware of these processes, it is necessary for Japan to build a framework of dialogue for Japan and the U.S. to cooperatively deal with new challenges together with the Obama administration.

We propose a review of the existing framework by taking into consideration the 5 pillars mentioned in 2 above and the prompt establishment of a "New Framework of Japan-U.S. Economic Dialogue" with the Obama administration including the elements shown below.

(1) Japan-U.S. Global Issue Dialogue (tentative name)

For Japan, which has advantages in technology and experience, to coordinate with the U.S., which now stands at an economic turning point, and search for cooperation items on global issues, such as climate change/energy and

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development, this will be both beneficial for Japan and the U.S., and will even be so for the global economy as a whole. For example, the search for new items of so called "Green (environment-related)" Japan-U.S. cooperation, such as new energy development (renewable energy) and development of next-generation transportation technology, and the consideration of how to combine these items into the economic/market system in both countries, will create a new economic growth model, and will enable us to lead the global economy.

Regarding policies for preventing global warming, it is important to construct an effective scheme, not to mention reduction on emissions, which is consistent with the environment and economy, and also will lead to the development of technology. Japan has many experiences on policymaking concerning global warming, for example, the "Top Runner" approach under the Law Concerning the Rational Use of Energy, the public announcement system under the Law Concerning the Promotion of Measures to Cope with Global Warming, and the promotion of the Voluntary Action Plan on Environment, in order to carry out the obligation under the Kyoto Protocol. Ambitious approaches are also about to start in the U.S. by the Obama administration. It is essential for both Japan and the U.S. to exchange opinions and information on measures for CO2 emissions-reduction by considering their domestic experiences and their experiences in the third country. Exchanges of opinion and information on the so-called "emission trading system" based on such approaches as the trial implementation in Japan, and the experience of state levels in the U.S., will benefit both nations to consider the actual introduction of the system. In addition, in order to eradicate poverty leading to the global income gaps, Japan and the U.S. can find ways to cooperate in the areas of comparative superiority of each country, such as food assistance in Africa, capacity building and development of new medical technology such as measures to fight infectious disease. Moreover, Japan and the U.S. can consider and propose how the development assistance should be, including the assistance toward the third country. These two actions will enable Japan and the U.S. to lead the global economy.



Therefore, we propose the establishment of the "Japan-U.S. Global Issue Dialogue" (tentative title), a dialogue that focuses on global issues in the broader sense of economic issues.

(2) Strengthening inter-ministerial coordination and moving with leadership level direction through the Japan-U.S. Strategic Economic Dialogue (tentative title)

Within a multilayered dialogue framework, the roles of the "forum for working on economic strategy" and the "forum for solving individual issues" should be distinguished, and a structure must be established whereby these fora deepen with the involvement and direction of the respective leaders of Japan and the U.S.

The economic relationship between Japan and the U.S. has elevated from the age of "friction", and today each individual issue does not require discussion at the leadership/cabinet level for decision-making to take place. However, political leadership is vital for the strategy/direction of the economic relationship between Japan and the U.S. which leads the global economy. It is necessary to work on the existing dialogues for each sector and renew the scheme of the new framework, keeping in mind the priority issues that need to be addressed under the current financial/economic situation. For that purpose, firstly, the "Japan-U.S. Strategic Economic Dialogue" (tentative title) should be established for strategic discussions. Thereupon,

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bearing in mind that the various issues, including the "5 pillars" as mentioned in Proposition 1, are interrelated, the framework should be designed so that each dialogue including 1 above should overcome the boundaries of the related ministries at the working level and coordinate organically with the "Japan-U.S. Strategic Economic Dialogue." Furthermore, the framework should be designed so that these activities obtain the involvement and direction of the respective leaders/related ministers of Japan and the U.S.

Additionally, the framework should fully coordinate with the Council on Fiscal and Economic Policy and the Japan-U.S. Business Conference etc., so that the above Japan-U.S. initiative moves strongly together with Japanese domestic economic/fiscal policy and private sector activities.

End Text

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